ACSI

Measuring and rewarding climate progress

June 2024

Climate change metrics in ASX200 variable remuneration structures

In Australia, listed companies are increasingly recognising the importance of managing material climate-related risks and opportunities. In the ASX200, the market has seen a significant increase in transparency and the setting of climate targets.

Alongside the increase in disclosure of climate-related risks, many boards have introduced climate-related measures in variable executive remuneration (most commonly through short-term and long-term incentives or bonuses). Public disclosures do not always make it clear how these incentives work and what is required to achieve them.

In this research paper, ACSI analyses the ways in which ASX200 companies have integrated climate-related metrics within variable executive remuneration structures to identify market trends and the performance measures used. The aim of the research is to understand these issues to promote good practice and identify gaps in disclosure. The research does not seek to proscribe which (and even if) specific climate measures should be adopted as this will vary between companies and sectors.

Key findings

- **There has been a boom in the adoption of climate-related incentive metrics:** 106 of 197 companies assessed, or 54% of companies in the ASX200, have factored climate change into either their short- or long-term executive incentive structures.[1] In FY20, just 10% of ASX200 entities had a climate-related remuneration metric within executive incentive pay.

- **Climate-related metrics are mostly short-term targets:** Nearly half of the ASX200 (47%) has incorporated climate-related metrics in short-term incentives (STI), only 11% have included it within their long-term incentive (LTI) structure.

- **Weightings to climate metrics are mixed:** Most companies do not disclose the specific weighting associated with the individual climate metric in the STI or LTI, rather it is more common for companies to include climate metrics within broader strategic or non-financial measures.

- **A wide range of targets have been adopted:** There is a wide range of measures included, with detail varying from specific emission reduction targets to vague and opaque metrics like '*targeting climate objectives*.' This makes it difficult for investors to understand how performance would be assessed, meaning there is a risk of discretionary and questionable payouts.

- **High risk sectors adopting climate metrics:** Most companies in highly exposed sectors including energy, materials, industrials, real estate and utilities have adopted climate-related remuneration metrics within their STI, LTI or both, to tie in with broader climate strategy.

[1] Note: some companies, such as externally managed entities, in the ASX200 are not required to disclose executive remuneration practices. Companies that do not disclose their executive remuneration practices have been excluded.

The prevalence of climate-related metrics in incentive structures

ACSI analysed the prevalence and nature of all climate-related metrics adopted by ASX200 companies and disclosed in remuneration reports. Many of these targets relate to managing and reducing emissions, developing low carbon opportunities, progressing decarbonisation projects, or the development of climate-related strategies. These metrics include standalone climate indicators and those included within a broader environmental, social and governance (ESG), sustainability, strategic or individual performance hurdle.

Metrics were only included where they were clearly identified and expressly disclosed a climate-related indicator within the remuneration report, either via a corporate scorecard or explanatory information provided on the targets. Climate-related metrics varied in weighting, targets and disclosures across the ASX200, with many scorecards lacking specific quantitative or qualitative measures tied to ascertainable climate targets.

Short-term versus long-term

There has been a large increase in companies integrating climate-related metrics into incentive structures (either short-term, long-term or both), from only 10% in FY20 to 52% of the ASX200 in FY23.

STI

92 companies, or nearly half the ASX200 (47%) have integrated climate-related metrics into STI structures or have clearly articulated plans to include it in their STI scorecard in 2024. For example, BHP, Bluescope Steel, Mirvac and Telstra.

LTI

It was much rarer to find climate-related metrics in LTI structures, with only 22 or 11% of the ASX200 including such a performance hurdle, or clearly defining how they would integrate a climate-related metric within their LTI in 2024. For example, Cleanaway, Dexus, Newmont and South32. A list of companies with climate-related metrics in their LTI are outlined below in the Appendix.

STI and LTI

11 companies (6% of the ASX200) include climate-related remuneration metrics in both their STI and LTI. All of these are in highly exposed sectors across utilities, industrials, real estate, materials and energy. For example, AGL Energy, Aurizon Holdings and Rio Tinto.

How are climate-related metrics included in ASX200 incentive structures?

While many companies integrate climate-related metrics, there is substantial variation in what these targets incentivise, the weighting that is placed within the overall STI or LTI structure and the level of detail provided to investors on how performance is assessed.

Common climate-related remuneration metrics include the achievement of emissions reduction targets; delivery or progress on abatement projects; or progress against strategic transformation objectives. Examples of theses disclosed measures include:

Orica has 15% of its STI linked to reducing Scope 1 and 2 greenhouse gas (GHG) emissions, and 20% of the LTI is linked to "Business Sustainability," for the FY24-26 grant, this is focused on portfolio resilience and diversification which includes (amongst other strategic objectives) moving towards a more "*progressive and sustainable commodity mix that are essential to a broader energy transition, including rebalancing [its]portfolio mix towards gold, copper, future-facing commodities and the Quarry and Construction vertical*". [2]

AGL has 30% of its LTI linked to the delivery of carbon transition metrics for FY24, with the board noting AGL's "commitment to reduce its carbon footprint and to facilitate the transition of AGL's thermal fleet responsibly over time." The carbon transition conditions, as outlined in its Notice of 2023 Annual General Meeting, include three sub-metrics that are equally weighted, to assess AGL's carbon transition progress:

- "*Emissions intensity of electricity supplies* – measured as the emissions (tCO2e) associated with the maximum of either AGL's electricity supply to the wholesale or retail market by state, as a proportion of that same volume (MWh).
- "*New total firming and renewable capacity from FY23 onwards (GW)* – measured as new total firming and renewable capacity in construction, delivered and contracted from FY23 onwards.
- "*Revenue uplift of green energy and carbon neutral products and services (5) from FY19, based on the Four*-Year Plan and internal AGL calculations – the base year of FY19 has been used to align with the CTAP."[3]

[2] Orica FY2023 Annual Report, p97 and 101; Orica 2023 AGM Notice of Meeting p14.

[3] AGL 2023 Notice of Meeting p10; AGL Energy Annual Report 2023, p 77.

Some companies incorporate climate-related metrics into their STI as a modifier or gateway to the overall STI payout. For example, Brambles applies a performance modifier that acts to increase or decrease each executive's STI outcome, subject to performance against published sustainability targets including reducing GHG emissions. Other examples of companies with modifiers or gateways include HMC Capital, Medibank Private, Perpetual and Treasury Wine Estates.

Elsewhere, companies provide climate-related metrics within a STI scorecard. This ranges from a 2.5% specific climate-metric to a company which links 40% of the STI to non-financial measures, including climate. Disappointingly, most companies do not disclose the specific weighting associated with the individual climate metric. Higher weighting always occurs where the climate-related metric is grouped with other non-financial metrics, such as other ESG factors or strategic objectives. The most common weighting for climate metrics within STIs, where disclosed and separate to other sustainability related metrics, is 10%.

Where climate is integrated in LTIs, it ranges from 7% - 60%[4], but generally comprises 20% of the overall LTI scorecard. Again, higher weightings are most often due to the coupling of climate within broader strategic objectives. Overall, the weighting to climate metrics within the LTI is better defined than STIs.

Gaps in reporting

Whether in STIs or LTIs, many climate-related metrics currently lack sufficient detail for investors to assess what the target relates to, how progress is measured and what is required for management to achieve the relevant threshold or performance target.

Climate-related metrics include quantitative and qualitative aspects, such as the delivery of projects. Whatever measure is adopted, it should be clearly defined and assessable. Our assessment found many climate hurdles were either vague or undisclosed, including companies disclosing incentives paid for '*targeting climate objectives*' and '*assessing climate risk and opportunity and making relevant climate disclosures*.' These types of disclosures reduce investor confidence in the veracity of performance measures.

It is important for investors to understand why an incentive is warranted and how targets reward outperformance. On climate-related measures, investors often ask how companies will meet specific measures. For example, where companies adopt "net" emissions reduction targets, many investors will wonder how using carbon offsets impact outcomes.

Better practice disclosures include clear parameters of what is targeted, the rationale for inclusion and how performance is assessed against the target. Bonuses, including for climate-metrics, should be sufficiently demanding to ensure pay-for-performance.

[4] The 60% is linked to a specific business unit of a company that is decarbonisation focused.

Climate-related metrics in climate-exposed sectors

Most companies in highly exposed sectors, such as energy and materials, have climate-related remuneration metrics within either or both of their STI or LTI. Between 62% to 67% of companies in the industrials, real estate, energy and materials sectors have adopted climate-related metrics. The three companies that make up the utilities sector within the ASX200 have all integrated climate-related metrics within remuneration structures – one of the three, within both their STIs and LTIs.

As shown below, many companies in carbon intensive, high emitting sectors have adopted climate-related metrics to tie-in with broader climate strategy. It is important that these measures are consistent with other disclosed incentives, or companies risk sending mixed messages to the market and their executive teams. An example of this challenge includes companies in the oil & gas sector disclosing emissions reductions targets sitting alongside traditional production growth targets in the bonus scorecard.

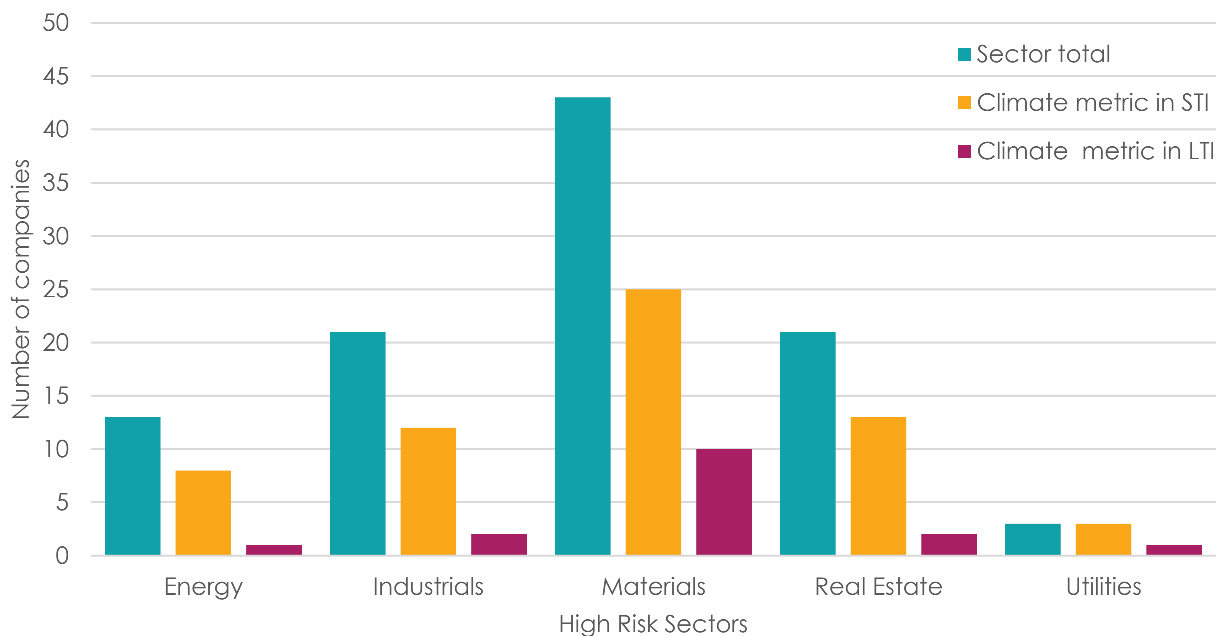

Figure 1: ASX companies in highly exposed sectors incorporating climate-related metrics within their STI and/or LTI, compared to the total number of companies in those sectors.

Conclusion

Ultimately, investors want management to be incentivised to deliver on the company's strategy, including climate strategy. Climate-related incentives, as with all other incentive metrics, must be aligned with company performance, with investors able to assess why management has been rewarded for delivery of a particular outcome.

The inclusion of climate-related metrics within discretionary executive remuneration at high-risk companies, and more widely across the ASX200, suggests company boards realise the financial materiality of climate change and the need to improve, or be seen to improve, their company's approach to climate risk. However, considerably more work needs to be done to ensure companies state why they have adopted climate-related metrics, clearly define the targets and reward outperformance.

An investor checklist for reviewing climate-related metrics:

- Do metrics align to the company's broader climate targets and strategy?
- Does the incentive timeframe match (as best as possible) milestones in the climate strategy?
- Does achieving the measure represent outperformance?
- Is the choice of metric/s clearly explained and performance transparently disclosed?
- Is scorecard metric weighting commensurate with the company's exposure to climate-related risks/opportunities?
- If short term milestones are targeted, how are longer term climate milestones incentivised?
- Do other metrics in the incentive structure undermine the climate-related metric?

Appendix

Metrics collected through review of public disclosures, up to the reporting period of 31 March 2024. This is based on public disclosure with best endeavours to collect the data for the reporting period. For detailed information refer to the company's own public reporting.

Company	Climate-related metric in LTI
AGL Energy Limited	**30%** weight to carbon transition conditions, which includes "emissions intensity of electricity supplied, new total firming and renewable capacity from FY23 onwards (GW) and revenue uplift of green energy and carbon neutral products and services (%) from FY19, based on the Four-Year Plan and internal AGL calculations."
Aurizon Holdings Limited	**25%** weight to the "growth of Non-Coal underlying EBITDA" over the performance period. The baseline for the 2023 Award reflects total underlying Group EBITDA less Network and Coal EBITDA.
Breville Group Limited	**20%** weight to progress against key strategic priorities, which includes (amongst others) "progress on the sustainability agenda including reduction in the Group's emissions footprint driven by increasing energy efficiency of products… recyclability of packaging… and full measurement and improvement of Scope 3 emissions including LCA by 2024…Progress on repairability and recyclability of products will also be assessed".
CAR Group Limited	**30%** weight to strategic measures, which includes (amongst others) "review[ing] business operations to deliver on the Company's carbon reduction strategy".
Cleanaway Waste Management Limited	**20%** weight to the Company achieving methane (CH_4) emissions targets over the 3-year performance period, ending 30 June 2026 including threshold at 30% vesting at 94% of FY22 CH_4 emission, pro rata linear vesting of between 30-50% where emissions are less than 94% down to 83% of FY22 emissions, pro rata linear vesting between 50-100% vesting, if emissions are less than 83% and, down to 66% of FY22 CH_4 emissions.
Dexus	**20%** weight to strategic measures which include financial and non-financial, including sustainability "to be globally recognised as an ESG leader in our industry". For FY23, this included receiving Climate Active certification and recognition as a global leader in sustainability in the S&P Global Sustainability Yearbook.
Fortescue Ltd	**34%** weight to key strategic measures for Fortescue Metals, which (amongst others) includes targets with respect to decarbonisation and green iron. **60%** weight to emissions reduction and strategic measures for Fortescue Future Industries which (amongst others) includes targets with respect to green industry, mobile fleet and stationary power.

Goodman Group	**20%** modifier subject to sustainability conditions, where Goodman materially underperforms against the Sustainability Targets, the board may determine that up to 20% of the Grant that satisfies the Operating EPS Performance Hurdle will lapse. The sustainability targets include renewably energy, solar PV installation, carbon neutral operations, TCFD, embodied carbon reductions and setting and validating Science Based Targets.
GUD Holdings Limited	**20%** weight to environmental, sustainability governance aligned group revenue. This is based on the increased percentage over the performance period of the automotive business revenue of the group which is "Non-ICE Revenue," being revenue derived from sales of products not related to internal combustion engine vehicles, aligned to "Plan GUD2025" which includes an objective to achieve 75%+ automotive revenue from non-ICE vehicle products by 2025, and +85% by 2030.
IGO Limited	**5%** weight to "delivery of IGO Decarbonisation Plan," which is part of the larger 30% weight to strategic project delivery.
Liontown Resources Limited	**15%** weight to ESG, measured against "FY26 renewable power and carbon emission target (aggregate emissions per tonne concentrate."
Newmont Corporation	**8%** weight to carbon reduction key project milestones, which is linked to Newmont's 2030 science-based climate target of reducing greenhouse gas emissions by 30%.
Northern Star Resources Ltd	**20%** weight to ESG which requires "tangible, sustainable Scope 1 and Scope 2 greenhouse gas emissions reduction of 200,000 tonnes CO2 equivalent between 1 July 2021 and 30 June 2027 below business-as-usual levels, to reward the Company's achievement of year on year absolute emissions reductions, aligned to the Company's targeted 35% reduction in absolute Scope 1 and Scope 2 emissions by 2030 (relative to a 1 July 2020 baseline of 931ktCO2e)."
Nufarm Limited	**11%** weight to ESG with a performance hurdle of being on track meet sustainability targets including a reduction in greenhouse gas scope 1 and 2 emissions from manufacturing sites by 30% by 2030.
Orica Limited	**20%** weighted to "Business Sustainability". The FY24-26 metric will be "focussed on Portfolio Resilience and Diversification" with reference made to "accelerating customer usage of more sustainable solutions" and "moving towards more progressive and sustainable commodities that are essential to a broader energy transition, including rebalancing our portfolio mix towards gold, copper, future-facing commodities and the Quarry and Construction vertical".

QBE Insurance Group Limited	**10%** weighted to a sustainability measure: "There are both quantitative and qualitative metrics linked to progress against a range of targets aligned to the sustainability focus areas detailed in the Sustainability Report". One focus area is "Foster an orderly and inclusive transition to a net-zero economy".
Rio Tinto Limited	**20%** weighted to "decarbonisation scorecard" which is broken down into four equally weighted parts relating to residual emissions (reduction relative to 2018 baseline), project delivery (for priority decarbonisation projects), technology development and transition strategy (alignment of decarbonisation activity with value creation).
Sandfire Resources Limited	**10%** weighted to climate, with a target of being "on track to achieve a 35% reduction in our Scope 1 and Scope 2 emissions by 2035 from our 2024 baseline".
South32 Limited	**10%** weighted to a "climate change strategic measure." Specific targets are not listed but reference is made to the 2035 emissions reduction target and the underlying activities to support its achievement. **10%** weighted to a "portfolio management strategic measure" to "reshape our portfolio and increase our exposure to the metals critical for a low-carbon future."
TPG Telecom Limited	**10%** weighted to a "Company ESG performance condition" which relates solely to "All operations being powered by renewable electricity by the end of the performance period". Vesting commences at 90% of operations (75% vesting) with straight-line vesting to 100% vesting of this component if 100% of operations are powered by renewable electricity.
Virgin Money UK PLC	**15%** weighted to the "ESG scorecard" which includes "quantitative targets including: operational carbon emissions; EPC ratings; Lending to Sustainability Change Makers; senior colleague gender and ethnic minority representation; Group-wide ethnic minority representation; and colleague engagement. In addition, the Committee will undertake a qualitative assessment on progress against the Group's 2030 ESG aspirations."
Viva Energy Group Limited	**15%** of the performance rights will be subject to a performance condition based on performance against agreed strategic measures over the performance period ('strategic component'). The strategic component includes, amongst other things, "develop the Energy Hub at Geelong and determine a long-term transition for the Geelong refinery" and "develop and deliver projects to achieve the Company's emission reduction targets and make meaningful progress on the Company's new energies and lower carbon agenda".

Australian Council of Superannuation Investors
Level 23
150 Lonsdale Street
Melbourne VIC 3000
Australia

P: +61 8677 3890
E: info@acsi.org.au
W: www.acsi.org.au